SBI RESEARCH
ECOWRAP

TODAY'S MONETARY POLICY HAS THE IMPRINT OF TECH SAVVY BUREAUCRAT BATTING FOR LESS RULES, MORE REFORMS USHERING IN TROIKA OF STABILITY, CONSUMER PROTECTION AND ECONOMIC INTERESTS ….APRIL COULD SEE THE NEXT RATE CUT AGAIN…..

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The growth-inflation-risk dynamics, together with optimization of economic benefits, got a new fillip today as the new MPC, and a new RBI stewardship, decided unanimously to revise the repo rate for the first time in two years, reducing it by 25 basis points to 6.25%. MPC, quite flexibly, also unanimously decided to continue with the neutral monetary policy stance and to remain unambiguously focused on a durable alignment of inflation with the target, while supporting growth.

RBI has kept its inflation projection for FY25 at 4.8% with Q4 at 4.4% (earlier: 4.5%). The outlook for inflation will be largely shaped by food inflation trajectory (on positive side: good kharif production, winter-easing in vegetable prices and favourable rabi crop prospects while on negative side: adverse weather events). CPI inflation for FY26 is projected at 4.2%. The tone and signal of the MPC have been unambiguously clear for the broader market forces while keeping the regulatory scrutiny and sanctity intact as reflected in the statement on developmental and regulatory policies.

The hallmark of the policy statement and the subsequent press brief is a clear communication to the market in terms of defined objectives. Specifically, the policy has underlined the importance of current flexible inflation targeting /FIT in no unambiguous terms. As the policy has clearly communicated a major advantage of FIT is that it combines elements of both "rules" and "discretion" in monetary policy. The spirit of such discretionary based regulation is clearly evident with the RBI emphasizing that the draft LCR, ECL and the provisioning norms will be delayed. These emphasis by the RBI thus adheres to the spirit of the regulation, but the RBI wants to use all available information in the future to take an appropriate call. We believe that this discretionary based approach is more relevant for emerging economies like India. This also provides sufficient justification for further rate cuts by RBI to spur growth.

The policy statement has several regulatory announcements:

Firstly, introduction of forward contracts in G-sec is important for strengthening price and rate trend discovery, apart from SWAPS/FRA mechanisms. The 2023 draft guidelines allows physical settlement of the G-sec along with the cash settlement, also mandating market-makers (SCBs) to undertake covered short positions in bond forwards. Since predominantly Bond FRA is being undertaken in long bonds (tenure greater than 30 years at present) in market, yields may move downward in the segment. As it provides additional avenue for market participants (Insurance / pension / MFs) to express their interest rate view, this will further enhance market liquidity. **Secondly,** access of SEBI registered non-bank brokers to NDS OM platform will be operationally convenient for stockbrokers since at present stockbrokers are required to keep margins in the form of securities or fixed deposits for derivative clearing of clients. With access of NDS-OM directly, they can purchase the securities directly from the platform which will get settled into their CSGL account and will be pledged while there is trade-off between securities and higher yielding FDs. **Thirdly,** uniformity of market and settlement timings in Forex, Equity and Debt markets will aid better liquidity management through comprehensive review of trading and settlement timings across various market segments. Further, scope of t+0 settlement may also be explored in all markets, taking a cue from equity playbook.

Fourthly, in a bid to reduce online financial frauds, the RBI will implement the 'bank.in' domain exclusively for banks in India starting April 2025. In a significant move aimed at enhancing the safety of online payments, RBI announced plans to introduce AFA for cross-border "Card Not Present" (CNP) transactions.

While the nudge from RBI to select banks for engaging in call markets is expected to improve the volumes on NDS-Call, it also needs to be seen if the surplus funds parked in SDF are due to inflows coming during post market hours. Generally, liquidity with Banks have remained tight and they are seen borrowing on TREPS/CROMS platform during the day. We believe a better target rate, instead of WACR, is the need of the hour since In principle, liquidity management per se still has some operational challenges like improving the market microstructure, a proper indicator of liquidity tightness in the system and most importantly maintaining a delicate balance between effective mix of durable and transient liquidity injection / withdrawal.

REPO RATE CUT BY 25 BPS AT 6.25%; STANCE KEPT AT NEUTRAL

- As expected, MPC has decided unanimously to revise the repo rate for the first time in two years, reducing it by 25 basis points to 6.25%. MPC unanimously decided to continue with the neutral monetary policy stance and to remain unambiguously focused on a durable alignment of inflation with the target, while supporting growth.
- RBI has kept its inflation projection for FY25 at 4.8% with Q4 at 4.4% (earlier: 4.5%). The outlook for inflation will be largely shaped by food inflation trajectory (on positive side: good kharif production, winter-easing in vegetable prices and favourable rabi crop prospects while on negative side: adverse weather events). CPI inflation for FY26 is projected at 4.2% with Q1 at 4.5%; Q2 at 4.0%; Q3 at 3.8%; and Q4 at 4.2%.
- RBI has projected FY26 real GDP growth at 6.7% with Q1 at 6.7%; Q2 at 7.0%; and Q3 and Q4 at 6.5% each. The growth trajectory is largely shaped by boost in household consumption (due to tax relief) among others. However, headwinds from geo-political tensions, protectionist trade policies, volatility in international commodity prices and financial market uncertainties, continue to pose downside risks to the outlook.
- The nominal GDP projection of RBI at around 10.7% (derived) is moderately higher than the Union Budget projection of 10.1%.

DEVELOPMENT AND REGULATORY MEASURES

- ***Introduction of forward contracts in Government securities:*** The 2023 draft guidelines allow physical settlement of the G-sec along with the cash settlement. It also mandates market-makers to undertake covered short positions in bond forwards. Since predominantly Bond FRA is being undertaken in long duration bonds in market, yields may move downward in select segments, while enhancing market liquidity as it provides additional avenue for market participants to express their interest rate view.
- ***Access of SEBI-registered non-bank brokers to NDS-OM:*** This move will be operationally convenient for stockbrokers due to flexibility in margin money as brokers are required to keep margins in the form of securities or fixed deposits for derivative clearing of clients.
- With access of NDS-OM directly, they can purchase securities directly from the platform which will get settled into their CSGL account and will be pledged.
- ***Comprehensive review of trading and settlement timings across various market segments:*** RBI has decided to set up a working group to undertake a comprehensive review of trading and settlement timing of financial markets regulated by RBI.

RBI Growth & Inflation Outlook for India

CPI Inflation (%)	Q3 FY25	Q4 FY25	FY25	Q1 FY26	Q2 FY26	Q3 FY26	Q4 FY26	FY26
Feb'25	5.6*	4.4	4.8	4.5	4.0	3.8	4.2	4.2
Dec'24	5.7	4.5	4.8	4.6	4.0	-	-	-
Oct'24	4.8	4.2	4.5	4.3	-			
Real GDP Growth (%)	**Q3 FY25**	**Q4 FY25**	**FY25**	**Q1 FY26**	**Q2 FY26**			
Feb'25	6.4**	6.8**	6.4 (NSO)	6.7	7.0	6.5	6.5	6.7
Dec'24	6.8	7.2	6.6	6.9	7.3	-	-	
Oct'24	7.4	7.4	7.2	7.3	-			

Source: RBI, SBI Research;*actual,**estimated from fan chart

- The Group is expected to submit its report by April 30, 2025. There is a need to rationalize and harmonize the timings of various market segments giving diverse market forces a holistic, 360 degree view of various asset classes and form strategies that augurs well for the ecosystem.
- ***Enhancing Trust in the Financial Sector through 'bank.in' and 'fin.in' domains:*** In a bid to reduce online financial frauds, the RBI will implement the 'bank.in' domain exclusively for banks in India starting April 2025. Further, it is planned to have an exclusive domain viz., "fin.in" for other non-bank entities in the financial sector. This initiative would ensure customers can distinguish legitimate banking websites from fraudulent ones.
- ***Enabling Additional Factor of authentication (AFA) in cross-border Card Not Present transactions:*** In a significant move aimed at enhancing the safety of online payments, RBI announced plans to introduce AFA for cross-border "Card Not Present" (CNP) transactions. This decision will bring international digital transactions using Indian-issued cards under the same security standards that have been applied to domestic transactions.
- AFA has already become a cornerstone of digital transaction security within India. By requiring an extra layer of verification—such as a One-Time Password (OTP) or biometric authentication—AFA has effectively reduced fraud in domestic online payments. Customers feel more confident making purchases online, knowing that their transactions are safeguarded.

LCR IMPLEMENTATION DEFERRED

- The proposed Liquidity Coverage Ratio (LCR) as well as project financing norms will get deferred by a year and are not to be implemented before March 31, 2026.

- The proposed guidelines issued on 25.07.2024 would have reduced the lendable resources of the banking system by Rs 4-5 trillions. Consequently, Banks would have faced tightening liquidity position and higher cost of deposits. High deposit rates and increased competition among banks will also affect the lending rates. RBI had asked for feedback and bank have raised these concerns. The usage of digital platforms will not necessarily resulted in volatile deposits. As the final guidelines are awaited and hopefully the RBI will address these concerns and the implementation will be done in a phase wise manner.

COMMUNICATION IS THE KEY TO MONETARY POLICY

- Central Bank communication across the world has been the subject of much intellectual discourse, but it has almost always been in the context of the communication of monetary policy. That is understandable because monetary policy is at the heart of central banking and also because communication of monetary policy is possibly more challenging than communicating other policies.
- In todays Policy, RBI Governor stated the experience of flexible inflation targeting (FIT) framework and how RBI has been able to manage to keep inflation in the targeted range.
- Furthermore, the statement by RBI regarding the exchange rate that market intervention done by RBI is only to bring stability in the exchange rate and not to bring any specific exchange rate level or band is a welcome statement to dispel the notions of unwarranted market speculations of change in RBI exchange rate management..
- In India, the communication has been very clear from the start that growth gets priority and RBI has reiterated that it will do "whatever it takes" to support the nascent recovery.
- Over the last two decades, central banks have moved towards clearer communication and greater transparency. This has been driven by several motivations. First, central banks have realized that open and transparent communication enhances policy effectiveness. This shift reflects a shift in the theory of monetary policy. Until the early 1990s, monetary policy was strongly influenced by Robert Lucas' argument that monetary policy affected real variables only if the policy changes were unanticipated.
- This encouraged obscurity over openness and clarity. Lost in the message was the fact that monetary policy always affected nominal variables like inflation even if fully anticipated. In the 1980s, Finn Kydland and Ed Prescott argued that fully transparent rules rather than discretionary policy changes were more efficient and credible. This was the beginning of the push towards rules over discretion and greater central bank transparency.
- While communicating policy after it is made is the standard mode of communication, central banks are taking to communication before policy action. This again is a lesson from experience — that the market does not like unexpected news, and that surprises should be avoided unless surprise is, in rare circumstances, part of the strategy itself.
- Central bank communication is important for the institution to learn, listen and understand. One is referring here not to the standard one-way oral or written communication but to two-way communication between the central bank and its stakeholders, with the central bank remaining largely on a listening mode as the RBI does at periodic intervals. Also, continuous interaction with the market (social media included) and all stakeholders is the best strategy for policy effectiveness and helps deflect threats to central bank credibility.

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